

**STATEMENT OF  
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DIRECTOR OF INSURANCE**

**INCREASING THE EFFECTIVENESS OF  
STATE CONSUMER PROTECTIONS**

**THE SUBCOMMITTEE ON OVERSIGHT & INVESTIGATIONS  
OF THE COMMITTEE ON FINANCIAL SERVICES**

**MAY 6, 2003**

Good Afternoon, Madame Chair and members of the Subcommittee. I appreciate the invitation to appear before you again.

Your hearing, "Increasing the Effectiveness of State Consumer Protections," is welcome, even overdue. There is no doubt that there is a great need to increase the effectiveness of state consumer protections and market conduct examination procedures. The efficiency of such exams should also be of interest to the Subcommittee.

The NAIC understands the importance of this issue for consumers. In its "Statement of Intent: The Future of Insurance Regulation", March 13, 2000, the NAIC declared, in the first sentence of that important document that:

Our primary goal is to protect insurance consumers, which we must do proactively and aggressively.

The Statement went on to say:

Market conduct is an essential regulatory tool. Its importance to regulators, producers and consumers will increase as the "Speed to Market" reforms are implemented and the marketplace evolves.

However, no one could deny that the state insurance commissioners have a poor record when it comes to market conduct oversight of the insurance industry. Consider the well-known abuses of the major life insurance companies such as Prudential and Met Life in the late 1980s and early 1990s as an example of this failure. Vanishing premiums that did not vanish, life insurance sold to unsuspecting nurses as a retirement plan, replacement of good policies with less valuable policies to gain commission dollars and other abuses hurt millions of people and cost the insurers billions of dollars in verdicts and settlements. Market conduct exams occurred only after legal actions had progressed to the point of proving the seriousness of the problems. Indeed, the New Jersey market exam of Prudential began only when Prudential requested New Jersey to come in as a way to head off more legal problems.

The lack of excellence in market conduct examinations by the states is particularly troubling in an era where less regulation of products is done at the time they are introduced, exposing consumers to greater risk of damage by "bad" insurance policies not reviewed by anyone in the state insurance department.

The unique nature of insurance policies (complex legal documents not easily understood by consumers) and insurance companies (granted anti-trust exemption via the McCarran-Ferguson Act, joint ratemaking/advisory bureaus, etc.) requires more extensive front-end regulation than other consumer commodities. And while insurance markets can be structured to promote beneficial price competition, deregulation does not lead to, let alone guarantee, such beneficial price competition<sup>1</sup>.

State systems should be designed to promote beneficial competition – price competition, loss mitigation efforts – and to deter destructive competition – selection competition such as redlining, reverse competition such as credit insurance (where the person selecting the policy, a bank or car dealer, for example, gets a commission and therefore selects high commission rather than low price and then another person pays the premium), other unfair sales practices and unfair claims settlement practices.

### Consumer Principles

Consumers believe the reinvention of market conduct standards and exams is the most important work of the NAIC at this time. Therefore this hearing is very timely, Madame Chair. We believe that the following eight items are important to consider as you look for ways to upgrade the State market conduct oversight capacity:

#### 1. High Uniform Market Conduct Standards Can Help Consumers

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<sup>1</sup> Consumers believe the NAIC movement toward deregulation (less front-end regulation) coupled with more back-end regulation (market conduct) is deeply flawed. From an efficiency and consumer protection perspective, it makes no sense to lessen efforts to prevent the introduction of unfair and inappropriate policies in the marketplace. It takes far less effort to prevent an inappropriate insurance policy or market practice from being introduced than to examine the practice, stop a company from doing it and providing proper restitution to consumers after the fact. This is a prescription for more lawsuits.

If more reliance is to be given to a “competitive” system at the front-end, consumers believe that the following must be in place:

- Policies must be transparent: Disclosure, policy form and other laws must create transparent policies. Consumers must be able to comprehend the policy’s value, coverage, actual costs, including commissions and fees, etc. If consumers cannot adequately compare actual costs and value and if consumers are not given the best rate for which they qualify, there can no true competition.
- Policies should be standardized to promote comparison-shopping.
- Antitrust laws must apply.
- Anti-rebate, anti-group and other anti-competitive laws must be repealed.
- Strong market conduct and enforcement rules must be in place with adequate penalties to serve as an incentive to compete fairly and honestly.
- Consumers must be able to hold companies accountable in court for losses suffered as a result of company wrongdoing.

Safeguards to protect against competition based solely on risk selection must also be in place to prevent redlining and other problems, particularly with policies that are subject to either a public or private mandate, such as auto and home insurance. If a competitive system is implemented, the market must be tested on a regular basis to make sure that the system is working and to identify any market dislocations. “Reverse competition” where the person selecting the insurer may get a commission or other kickback and another party pays the premium must be controlled as well. Standby rate regulation should be available in the event the “competitive model” is dysfunctional.

Minimum standards for market conduct examinations would be good for consumers, if the standards were high and enforced. Consumers have supported minimum national (NAIC) or minimum federal market conduct standards. We agree that consistency in market standards is a good approach but we are very concerned about weak uniform standards. Even with uniformity and strong standards there must be state exceptions, however. For example, it may not be appropriate for every state to require multilingual customer service departments but for some states it may be essential.

## 2. Use of Accreditation Process

Use of an accreditation-type approach has worked to upgrade state financial examinations. Application of accreditation to market conduct could serve consumers well if the standards for market conduct adopted are high, based on best practices from around the nation. Uniform low standards will not be acceptable to consumers.

## 3. Enforcement

Standards must include enforcement criteria. For example, if a state has a minimum loss ratio standard for consumer credit insurance in its laws but no company meets the standard, the state has not met its obligation to its consumers.

## 4. Private Causes of Action

Private causes of action are an important compliment to market conduct exams for two reasons: (1) market conduct exams are prospective and can not grant restitution to already harmed consumers and (2) consumers do not trust the track record of the NAIC and the states to make market conduct systems fully effective to root out corporate misbehavior.

The NAIC is considering whether class action lawsuits somehow undermine their authority to regulate insurance. This is chutzpa of the highest order given the fact that these lawsuits and bad faith lawsuits have easily done more to protect consumers than all of state regulation combined. These lawsuits reveal the weakness of the current State market conduct oversight approach. The lawsuits are not a threat to effective regulation, only a spotlight on ineffective regulation. The states should welcome this assistance given their woeful record on finding serious problems when they undertake market conduct exams.

## 5. Self-certification has only Limited Application to Insurance

Consumers strongly oppose self-certification programs in the form that some in the industry have proposed. The abysmal record in the area of market conduct by the industry speaks for itself, e.g., redlining, life insurance market conduct abuses, race-based life insurance pricing, numerous claims practice abuses. For regulators to consider a system of handing review over to the industry in any way that would replace part or all of the state process demonstrates a lack of commitment to consumer protection. In the post-Enron era, reliance on self-certification is problematic at best. This is not to say that self-certification could not be part of what a state looks at in determining whether an insurer is meeting state standards. However, if a state relies at all on such information, it must be made public and the tests made by the self-certification group (such as IMSA) must be transparent. We must see when an insurer fails a test and not just be given a seal of approval with no information on what the tests are, how they are scored and the individual insurer's scores. Consumers cannot trust a "black box" system of certification where the substantive results remain beyond public view.

## 6. Consumer Feedback

Consumer feedback to the insurance department should be sought after every transaction (e.g., after policy sale, renewal, termination, claim denial). Insurers should give consumer notice of this feedback procedure at end of the transaction, e.g., form on-line or toll-free telephone number. This information can feed into the market conduct exam process and help focus the examiners on the trouble spots as consumers see them.

## 7. Suitability

Suitability or appropriateness rules should be in place and strictly enforced through the market conduct process, particularly for investment/cash value life insurance policies. Companies must have clear standards for determining suitability and compliance mechanism. For example, sellers of variable life insurers are required to find that the sales that their representatives make are suitable for the buyers. Such a requirement should apply to all life insurance policies, particularly when replacement of a policy is at issue.

## 8. Data needed to Undertake Market Analysis

The NAIC should be collecting or requiring states to collect data sufficient for market analysis. These data should include not only information on market shares, entries, exits and so on but also such information as Zip Code data to see if redlining is occurring, information on third party vendors who impact underwriting and pricing with products such as Credit Scores and CLUE claim reports, and other data needed to test the viability of specific markets within the state.

### NAIC Progress on Market Conduct Exams is Spotty

#### There are Some Advances

The NAIC has been working for many years to upgrade the market conduct examination process. There has been some progress in this regard. The Examination Tracking System (ETS) is a tool by which regulators communicate an upcoming market conduct exam and by which results of exams can be disseminated. Improper marketing, underwriting and sales practices information is shared via the Special Activities Database, the Regulatory Information Retrieval System, the Complaints database and the Producer database. Data for some, but not all, of the market analysis needed is being collected on a trial basis.

#### Overall Disappointment

The NAIC has failed to achieve either effective examinations or efficient examinations. The insurers have complained about the latter problem, since some insurers have multiple exams covering the same topics. Consumers agree that efficiency must be achieved, given limited state regulatory resources.

The market conduct examination data imply that it takes over 10 years for a the average state to complete any (full or targeted) market conduct exams on its domestic insurers and over 90 years to complete such exams on foreign insurers (See spreadsheet attached). When one considers that there were 714 full market conduct exams completed and there are 3,652 insurers in the nation, that implies that a typical insurer (assuming that states cooperate

perfectly and there are no duplications of effort) is reviewed in full once every 5+ years or so, assuming 100% cooperation between the states and no duplication. We know that cooperation is not 100% and there is duplication, so the number of years needed to look at all companies at the current pace of State exams is well over 5 years and likely in the 10 year range.

It is very disappointing that, after years of effort and focus at the NAIC on this issue that the domestic state takes over 10 years to look at all the companies that are based in its jurisdiction and overall a similar number is in place for all exams. The states must upgrade these results significantly.

Further, the NAIC does not seem to be able to uncover major and widespread abuses and obtain prospective reform (much less restitution for past damages, which will likely always requires lawsuits). I mentioned the infamous market conduct abuses in the life insurance industry. A case that seems to cry out for consideration of a market conduct effort is State Farm Mutual Auto. Despite what seems to be strong evidence of a plot called "Performance, Planning & Review" at State Farm which appears to attempt to systematically underpay claimants (documented in the case of State Farm v. Campbell<sup>2</sup>) no market conduct examination to review (and, if proven to exist, end) such practices by this leading insurer has been done to CFA's knowledge.

The NAIC Market Conduct Working Group has been at work to improve these examinations. But there are key things left undone after years of effort. For instance, no examination of what went wrong in the previous exams that resulted in the state exam system not detecting significant wrongdoing that later was uncovered by discovery in a lawsuit. It is hard to improve a system that has not been critically analyzed.

There has not been a decision to obtain critically needed information such as underwriting guidelines (which are used by insurers to decide which risks to write or not write and which also indicate the reasons some persons are sent to higher priced situations such as running mates or tiers). Not has the NAIC begun to collect claims handling guides, a major area of consumer abuse.

Nor has the NAIC called upon the states to obtain required data to test markets and determine if the market is under serving certain consumers. Zip code data, for example, could be used to determine if redlining is occurring by any insurers. Use of these data when I was Texas Insurance Commissioner resulted in insurers agreeing to increase market shares in underserved areas of Houston and Dallas. The NAIC will currently not order such information for use as part of market conduct examinations.

Absent from the working group's work are standards by which to test whether the state's market conduct function is adequate, e.g., resources. There is no use of testing by persons posing as policyholders to determine if insurers are using inappropriate underwriting guidelines, no surveys of policyholders and agents to see how insurers rank in their opinions,

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<sup>2</sup> State Farm Mutual Insurance Company v. Campbell, Et al, US Supreme Court, Slip Opinion, April 7, 2003. In the decision, the Justices called State Farm's claims practices "reprehensible conduct." In her dissent, Justice Ginsberg listed many of these outrageous practices (falsifying and withholding evidence, pressuring claims representatives to pay below fair value, unjustly attacking a claimant and so forth). Details of the practices can be read at length at Campbell v. State Farm Mutual Automobile Insurance Company, Third Judicial District Court of Salt Lake County, State of Utah, August 3, 1998, at paragraphs 29 – 80.

no meaningful suitability requirements in place and no other methods to build up consumer confidence in the market conduct exams.

All information on market conduct exams, including underwriting and claims settlement guides should be posted on the web. Only two states do so according to CFA's last review of state web pages.

#### Responses to the Subcommittee's Questions

1. *Please describe how the current patchwork State system of market conduct regulation is creating expensive regulatory burdens in some areas, while failing to protect consumers in others by failing to set standards and target resources.*

RESPONSE: While some insurers with good records are subject to repeat exams covering the same areas, the States have failed time and time again to catch the really critical issues that harm consumers, such as market conduct abuses or unfair claims settlement practice abuses. There needs to be a refocus of the exams to upgrade consumer protection.

2. *Please describe how the creation of a systematic approach to market conduct regulation with a focus on market analysis and uniform standards would benefit consumers.*

RESPONSE: Minimum standards for market conduct examinations would be good for consumers, if the standards were high and actually enforced. Consumers have supported minimum national (NAIC) or federal market conduct standards for many years. We agree that consistency in market standards is a good approach but we are very concerned about weak uniform standards. Even with uniformity and strong standards there must be state exceptions, however. For one clear example, it may not be appropriate for every state to require multilingual customer service departments but for some states it may be essential.

3. *Please evaluate current NAIC and NCOIL efforts to develop a more uniform, coordinated, systematic approach to market conduct oversight.*

RESPONSE: See section "NAIC Progress on market conduct exams is spotty." The new NCOIL proposal, just completed by Price, Waterhouse, as we understand it, has not yet been available for CFA's review. We will comment once we have seen the report.

4. *How critical is it that States adopt and implement objective and written best practices standards for market conduct oversight?*

RESPONSE: In order to achieve high standards, best practices are an excellent approach. Consumers must be at the table as these best practices are reviewed and standards are set. Further, we support an accreditation-type approach to assure that states actually adopt these high standards rather than having them sit on a shelf unused (as often happens with NAIC Model approaches).

5. *How can the States ensure the reliability of coordinated or reciprocal market conduct oversight with proper enforcement criteria?*

RESPONSE: An accreditation program can assure that there will be coordinated/reciprocal efforts by the states in implementing market conduct systems. A private right of action is necessary to test the reliability of any system. The more effective the system, the less use of such actions will be required, except to gain restitution for persons harmed by a practice introduced between exams, something the market conduct exams appear unlikely to ever accomplish.

Appendix A -- CV

**J. ROBERT HUNTER**

**CURRENTLY**

- Director of Insurance, Consumer Federation of America (pro-bono)
- Consultant on Public Policy and Actuarial Issues  
(Practice limited to government agencies and consumers)

**EXPERIENCE**

- Commissioner of Insurance, State of Texas

- President and Founder, National Insurance Consumer Organization (pro-bono)
- `Consultant to Government Agencies and Consumers  
(Clients included federal agencies including HUD, GAO, and EPA as well as states such as CA, FL, GA, MA, ME, NC, NJ, NY, OK SC, TX)
- Federal Insurance Administration, serving as:  
Federal Insurance Administrator  
Deputy Federal Insurance Administrator  
Chief Actuary
- Private Insurance Industry experience, including:  
Associate Actuary, Mutual Insurance Advisory Association and Mutual Insurance Rating Bureau (now AIPSO)  
Actuarial Supervisor, National Bureau of Casualty Underwriters (now ISO)  
Underwriter, Atlantic Mutual and Centennial Insurance Companies

## **AWARDS**

- HUD Secretary's Award for Excellent Service, for work performed from 1971 to 1977
- Esther Peterson Consumer Service Award for lifetime service, CFA, 2002
- Schraeder-Nelson Publications Award; article of the year for Enron's Impact on State Insurance Regulation, Regulator Magazine, Insurance Regulatory Examiner's Society 2002

## **PUBLICATIONS**

Taking the Bite Out of Insurance: Investment Income in Rate making, 1980

Gas Prices and Auto Rates: Insurance Implications of the Dynamic Changes in America's Driving Habits, 1981

Study of the Feasibility of Risk Retention Groups for Hazardous Waste

Worker's Compensation Insurance Rate making: Regulation of Profit Margins and Investment Income, U. S. Department of Labor, co-authored with Professor R. Hill of Princeton University, 1983



Investment Income and Profitability in Property/Casualty Insurance Rate making, NAIC Investment Income Report, co-authored with J. W. Wilson, 1983

Insurance in California: Profitability, Competition and Equity in Selling and Pricing Private Passenger Automobile Insurance and the Crisis in Day-Care and Municipal Liability Insurance, California State Legislature, 1986

Private, Pay-at-the-Pump Auto Insurance, 1992

Studies of the Quality of State Regulation (Brochure Excellence, Complaint Data Quality, Web Page Usefulness, Resource Adequacy), CFA, 1999-2000

### **NAIC ACTIVITIES**

1993-4 Member of NAIC

1993-4 Member, NAIC Executive Committee

1993-4 Vice-Chair, Western Zone of NAIC

1992-3 Funded Consumer Representative to NAIC

Served as advisor to NAIC on several projects dealing with profit, rate making, market conduct and other consumer issues

STATE	Number of Domestic Insurers	Domestic Market Coduct Exams completed 01	Years to do all domestic insurers		Number of Foreign Insurers	Foreign Market Coduct Exams completed 01	Years to do all foreign insurers
Alabama	53	16	3.3		1277	1	1277.0
Alaska	8	0	Forever		1063	0	Forever
Arizona	398	7	56.9		1525	124	12.3
Arkansas	74	18	4.1		1464	0	Forever
California	219	74	3.0		1210	74	16.4
Colorado	74	5	14.8		1410	19	74.2
Connecticut	132	14	9.4		1055	27	39.1
Delaware	144	28	5.1		1426	2	713.0
Dist. of Col.	23	0	Forever		1347	0	Forever
Florida	201	28	7.2		1612	68	23.7
Georgia	106	5	21.2		1473	20	73.7
Hawaii	117	3	39.0		926	0	Forever
Idaho	23	6	3.8		1426	1	1426.0
Illinois	446	12	37.2		1469	15	97.9
Indiana	183	1	183.0		1598	2	799.0
Iowa	220	33	6.7		1403	0	Forever
Kansas	57	1	57.0		1642	0	Forever
Kentucky	52	1	52.0		1504	9	167.1
Louisiana	147	20	7.4		1485	12	123.8
Maine	33	0	Forever		925	2	462.5
Maryland	96	12	8.0		1392	40	34.8
Massachusetts	94	11	8.5		1273	50	25.5
Michigan	142	36	3.9		1383	0	Forever
Minnesota	94	4	23.5		1438	0	Forever
Mississippi	70	15	4.7		1428	3	476.0
Missouri	247	6	41.2		1411	42	33.6
Montana	28	0	Forever		1407	0	Forever
Nebraska	113	9	12.6		1440	24	60.0
Nevada	39	7	5.6		1704	12	142.0
New Hampshire	49	2	24.5		859	10	85.9
New Jersey	101	5	20.2		1165	6	194.2
New Mexico	19	5	3.8		1476	3	492.0
New York	505	90	5.6		927	69	13.4
North Carolina	97	9	10.8		1243	30	41.4
North Dakota	42	2	21.0		1378	0	Forever
Ohio	275	27	10.2		1505	11	136.8
Oklahoma	104	28	3.7		1480	9	164.4
Oregon	139	13	10.7		1486	2	743.0
Pennsylvania	313	13	24.1		1404	9	156.0
Rhode Island	33	1	33.0		1210	5	242.0
South Carolina	50	14	3.6		1424	3	474.7
South Dakota	52	0	Forever		1403	3	467.7
Tennessee	111	26	4.3		1559	0	Forever
Texas	512	29	17.7		1529	2	764.5
Utah	45	12	3.8		1423	0	Forever
Vermont	410	0	Forever		937	4	234.3
Virginia	82	23	3.6		1407	35	40.2
Washington	69	3	23.0		1336	11	121.5
West Virginia	20	3	6.7		1304	0	Forever
Wisconsin	355	13	27.3		1536	3	512.0
Wyoming	4	1	4.0		1304	0	Forever
Countrywide	7020	691	10.2		69411	762	91.1
Average	138	14	10.2		1361	15	91.1

Source: 2001 Insurance Department Resources Report, NAIC

NOTES: \* California reports 148 completed MC Exams but no breakdown between domestic &amp; foreign.

Assigned half of the completed exams to each.

\*Includes both Market conduct exams and combined financial/market conduct exams.

\*Of all completed Exams, 714 were routine and 738 were targeted.

\* Reliance on other state exams will reduce the years to complete indications, particularly for foreign companies.